(27)

IN THE

Supreme Court of the United States

OCTOBER TERM, 1944.

No. 1024

IN THE MATTER OF
WAERN BUILDING CORPORATION,
DEBTOR.

ERNEST MORRILL,
Petitioner,
vs.
WAERN BUILDING CORPORATION,
Respondent.

BRIEF OF RESPONDENTS IN OPPOSITION.

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STATEMENT OF THE CASE.

In Petitioner's brief (p. 2) it is stated that a statement of the matter involved has been fully presented on pages 2 to 6 of the petition, to which the Court is referred. Attention of the Court is respectfully called to the fact that under the heading "Statement of the Matter Involved" in the petition, pages 2, 3 and the first half of page 4 is pure argument and has no place under the Statement of the Case, but inasmuch as petitioner has inserted such arguments therein, we feel impelled to answer under the same

heading to correct any erroneous impressions which petitioner may have conveyed.

On pages 2 and 7 of the petition it is stated that the plan reduced the interest on the bonded indebtedness from 7% to 4½% and permitted stockholder participation. That is not so; the plan provided for the extension of the maturity of the bonds for six years, and the rate of 4½% was the average rate of interest which the bondholders had received for the six years prior to the date of extension under a former plan of reorganization. The 7% referred to is the rate specified in the indenture as the rate payable after maturity, but the bonds not having matured because of the extension agreement, the interest rate had never been 7%. The full priority rule was completely observed as will be more fully set forth below.

On pages 2 and 3 of the petition, it is argued that the opinion of the Circuit Court of Appeals precluding petitioner from raising the specific objection that the priority rights of the bondholders were affected by the plan's provision as to interest rates was erroneous because the trust indenture "is in evidence and clearly shows a violation of the priority rights of the bondholders." On the contrary by the very terms of the trust indenture there is no violation of the priority rights, and the writer of the opinion stated that even on the merits of the case there was no violation of any priority rights; moreover, such a specific objection could not be raised in an Appellate Court for the first time. This contention also will be argued fully below.

On pages 3 and 4 under "Statement of Matter Involved," petitioner cites several Illinois cases, and states that the ruling of the Court below is in conflict with the decision of the Courts of Illinois. None of the cases are remotely connected with the issue here involved. The cases cited on page 3 all hold that a mortgagee, upon foreclosure, is entitled to interest on the mortgage note at the contract rate

from the date of the note until the rendition of the decree, and after that date at the legal rate for the amount found due. The Illinois case cited on page 4 was reported in abstract only, and the Court on this point merely held that an accelerating clause in a note secured by a trust deed did not make the loan usurious. Such holdings are not in conflict with the decision of the Circuit Court of Appeals in this case.

On page 7 petitioner intimates that there is no equity for the Class A Preferred Stock. The Court, however, affirmatively determined there was an equity for such shareholders.

The allegation (p. 7) that the debtor's past record, over 14 years, demonstrates its incapacity to meet the requirements of the sinking fund payments, is not borne out by the evidence presented before the Referee. The plan is to be in effect for six years and it was amply shown that for the life of the plan the income of the property will be more than sufficient to meet all sinking fund requirements, and the Referee so found (R. 107).

ARGUMENT.

I.

A PLAN OF REORGANIZATION OF A SOLVENT CORPORATION WHICH PERMITS STOCKHOLDERS TO PARTICIPATE TO THE EXTENT OF THEIR EQUITY, AND WHICH AFFORDS BONDHOLDERS EVERY RIGHT WHICH THEY HAD PRIOR TO THE ADOPTION OF THE PLAN IS FAIR AND EQUITABLE AND DOES NOT VIOLATE THE "ABSOLUTE PRIORITY RULE."

To determine whether or not the "absolute priority rule" as cited by petitioner has been violated in a given plan of reorganization it is necessarily essential to determine the rights of the creditors both before the filing of the petition for reorganization, and their respective rights as given them under the plan.

Under the original plan of reorganization confirmed in 1936 the bonds and trust indenture provided that interest shall be payable at the rate of 4% per annum from May 10, 1936 to May 10, 1939, and at the rate of 5% per annum from May 10, 1939 to May 10, 1942. A clause as to an accelerated rate of interest of 7% after maturity was contained therein. The original plan also provided for common, Class A Preferred and Class B Preferred stockholders.

After hearings on valuation were had before the Referee in the present proceedings, the court determined that there was no equity for the Common and Class B Preferred Stock, and they were eliminated from any participation; it expressly determined that the Class A Preferred Stock did have an equity in the property and it was permitted to participate on the basis of such finding (R. 184-185). This finding, after deliberations and hearings on valuation, per-

mitting the stockholders to participate *only* to the extent of what was determined to be their equity is in full accord with the principle laid down in *Case* v. *Los Angeles Lumber Products Co.*, 308 U. S. 106. What the Court denounced in the plan submitted in that case was the fact that though the debtor was admittedly insolvent the creditors were compelled to surrender 23 per cent of the value of the enterprise to the stockholders.

The present plan extends the maturity date of the bonds for six years and provides for an interest rate of 4½%, which is the average rate of interest the bondholders received under the trust indenture and bonds up to the time of the filing of the petition herein. The plan further provides that *all* of the net rentals must be deposited with the indenture trustee and the trust indenture provides that any monies remaining after payment of operating costs, interest, etc. shall be deposited in the fund for the redemption of bonds (R. 62-63). As was said in the opinion of the Circuit Court of Appeals, "Any stockholder participation here is more nominal than real * * *." Thus it cannot be said that any rights of creditors are being cut down, since no payment of dividends or any other participation in the income by stockholders is permitted; for the life of the plan (to May 10, 1948) all of the earnings will be utilized for the benefit of the bondholders alone. There is no subordination whatever of the interests of any of the creditors to that of any of the stockholders.

The only real contention as to the plan's unfairness and inequitableness is that the bondholders, according to the illogical view of petitioners, were entitled to receive 7% interest if stockholders participated. The petitioner states in his brief (p. 6) that two of the three judges of the Court of Appeals apparently did not concur with the writer of the opinion that the priority rule was not violated. There is no support for that conclusion. All three of the judges

agreed that the petitioner was precluded from raising this question for the first time on review; so far as the result was concerned no more need have been said on this point. Judge Kerner, however, continued by pointing out, as his own view, that even if petitioner had not been so precluded the contention was unsound on its merits. There is no intimation in the opinion that the other judges disagreed with Judge Kerner's views; they merely stated that because the question had never been presented below they would give no consideration to the contention, and expressed no disagreement with Judge Kerner.

The 7% interest was payable, by the terms of the trust indenture and bonds, *after maturity*. The petitioner seeks to convey the impression that the bonds and trust indenture provide for 7% interest after May 10, 1942, and that this date is specifically recited in the clause wherein the accelerated rate of interest is mentioned; the recital is that the notes "shall bear interest after maturity at the rate of 7% per annum" (R. 56).

The rate of 4½% interest provided in the present plan is merely the average rate which the bondholders received under the indenture for the period of the original extension, and allows them the same return under the proposed extension as they received in the previous period. Nothing whatever is being taken from the bondholders for the benefit of the stockholders; the priority of the bondholders is maintained and the bondholders will receive the same rate of return after the plan is put in effect as they formerly did.

The plan simply provides that the existing first mortgage notes maturity dates shall be extended from May 10, 1942 to May 10, 1948. This is the foundation of the entire plan —the extension of the maturity date—and the original notes are in full force and effect except for the fact that they will mature in 1948 instead of 1942. Inasmuch as the notes will not have matured, by reason of the extension

agreement, it cannot logically be asserted that the interest rate provided for "after maturity" must be the rate which the bondholders must receive if stockholders participate. Certainly it cannot be contended that in the event of an extension it was contemplated that interest thereafter should be at the rate of 7%. The participation of the creditors under the plan is precisely the same as it was before the petition was filed; their priority is completely maintained, their return is precisely the same, and their position is preserved to the full amount of their principal and interest. They are in certainly as good a position as they were prior to the filing of the petition herein and certainly they cannot legitimately complain that they should be given rights to participate to an even greater degree than they did before the plan was proposed. It is only where participation by stockholders is permitted in excess of what is determined to be their equity, or where the creditors are deprived of the full compensatory rights which they formerly enjoyed and there is some scaling down of their interests in favor of stockholders that the priority rule is violated. The proposed plan does neither; the maturity is extended, and thus the bonds have not matured and the rate of 7% is payable only *after* maturity. Upon the approval and confirmation of the plan these bonds will not mature until 1948; the "after" maturity rate of 7% cannot apply before that date.

Petitioner attempts to argue that the Illinois court's decisions are somehow in conflict with the decision of the Court of Appeals on this point. An examination of the cases cited (*Schmisseur* v. *Rebhan*, 13 N. E. (2d) 627, 294 Ill. App. 172, 179; *Arneson* v. *Haldane*, 105 Ill. App. 589; *Carson* v. *Rebhan*, 13 N. E. (2d) 630, 294 Ill. App. 180, 183) discloses that all of these cases merely hold that the mortgagee, upon foreclosure, is entitled to interest on the mortgage note at the contract rate from the date of the note

until the rendition of the decree of foreclosure and after such date at the legal rate (5%) on the full amount found due. None of these cases deal with an accelerated interest rate of 7% after maturity, if provided in the note, and merely mention the "contract rate," whatever such rate may be. Indeed, the case of *Carson* v. *Rebhan* held that the interest should have been computed at 6%, the contract rate.

As for the statement in petitioner's brief, (p. 9) that several plans allowing 7% after maturity as fixed by bonds and mortgages have been approved in the District Court, neither the facts nor the opinions in these cases are set forth. Without the facts or opinions, asserting that certain plans were approved by a District Court can carry no weight whatever in the determination of the issue here presented.

Petitioner further cites the cases of *Group of Investors, et al.* v. *Chicago, Milwaukee, St. Paul & Pacific Railroad Co.*, 318 U. S. 523, 546; *Consolidated Rock Products* v. *DuBois*, 312 U. S. 510, 527; and *Coder* v. *Arts*, 152 Fed. 943, 950 (C. C. A. 8th), as sustaining his contention that the 7% interest rate must be the rate provided for in the plan. None of these cases so hold; they merely hold that interest on secured claims could not be cut off or wiped out any more than the principal, if junior securities participate. The interest referred to, however, is interest unpaid on due dates regardless of whether such dates fell before or after the filing of the petition, and provisions for such interest must be included in the plan. This does not mean, however, as petitioner contends, that a provision in the original notes as to an accelerated rate of interest after maturity must be the interest rate which is to be included in the plan if stockholders participate, where the maturity of the notes is extended under the plan. In the proposed plan the right of the bondholders to interest accrued on the

bonds is recognized and given the same priority as the principal and payments of such interest have been made on each due date (R. 176 and 212).

In determining that a proposed plan was fair, equitable and feasible, the court in *In Re Central Forging Co.*, 38 F. Supp. 18, 19 (D. C. M. D. Pa., 1941), said the following with respect to the rights of bondholders:

> "It means that their rights must be so preserved that, if the reorganized company succeeds and profits, the first fruits of that success or profits will go to the bondholders, or if the reorganized company fails to succeed, the bondholders' contribution will be protected first."

In the plan here proposed the bondholders have been afforded full priority rights over the stockholders; all earnings for the life of the plan are to be utilized for their benefit; their position has been preserved to the full extent of their principal and interest; there is no derogation of their interests in favor of stockholders, and the plan is fair and equitable in fact and in law.

II.

WHERE A SPECIFIC OBJECTION TO A PLAN OF REORGANIZATION IS NOT RAISED BEFORE THE REFEREE OR THE DISTRICT COURT, THE OBJECTOR IS PRECLUDED FROM RAISING SUCH OBJECTION FOR THE FIRST TIME ON APPEAL.

Petitioner concedes that an objection may not ordinarily be raised for the first time in a reviewing court, but contends that in the case of a reorganization proceeding under the Bankruptcy Act he may for the first time offer specific objections to a plan despite the fact that such matter was never presented below. The contention seems to be that in reorganization proceedings the scope of the Circuit Court of Appeals' jurisdiction is broader than is the case in ordi-

nary litigation, and that different rules apply to such proceedings. Sections 47 and 48, Title 11 U. S. C. A., dealing with the jurisdiction of the Circuit Court of Appeals in bankruptcy matters, confer upon the Circuit Court of Appeals appellate jurisdiction only; these courts are not vested with original jurisdiction, and they have in bankruptcy proceedings, as in all other litigation, appellate jurisdiction only.

In *Amick* v. *Columbia Casualty Co.*, 101 F. (2) 984, 986 (C. C. A. 8th), the court said:

> "This court is not a court of bankruptcy. In bankruptcy proceedings its jurisdiction is purely appellate."

The function of an appellate tribunal is to review the proceedings below and to determine whether or not there was error in such proceedings. Certainly the court below cannot be said to have erred for failing to consider objections not presented to it. To hold otherwise would change the whole procedure before the Circuit Court of Appeals from review to an original inquiry.

It may well be that a judge has the duty of affirmatively determining whether or not a plan is fair, equitable and feasible despite lack of objections or evidence to the contrary. Where, however, objections are desired to be made to a proposed plan, the forum in which to make such objections is in the bankruptcy courts, which Congress has designated as the District Courts of the United States (11 U. S. C. A., Sec. 1). It would indeed be anomalous to permit an objector to refrain or refuse to offer specific objections to a proposed plan in the District Court, and then permit such objections to be introduced for the first time in a purely appellate tribunal.

The contention that the trust indenture being in evidence and that since "it was patent from an examination of this document that the rights of bondholders were violated by

the plan," it was not incumbent upon the objector to specifically point out the objection, is obviously not worthy of merit. In the first place, if the rights of bondholders were so patently violated by the plan, and if a mere reading of the trust indenture would so disclose, why did not petitioner, who throughout so actively resisted the confirmation of the plan, immediately discover such violation and call it to the attention of the court? The answer is that no violation of the rights of the bondholders is disclosed by the trust indenture. In his objection to the confirmation of the plan, petitioner listed nine specific objections to the fairness, equitableness and feasibility of the plan, yet failed to make any mention whatever as to the alleged violation of the rights of the bondholders in not receiving 7% interest under the plan (R. 153, 154). It is obvious that this objection was an afterthought on the part of petitioner; objections which could have been made, and were not, should be deemed to be waived and not permitted to be thrust in as an afterthought upon appeal.

The rule of appellate procedure denying parties the right to raise new issues and introduce new matters for the first time in the reviewing courts extends to every field in which the courts exercise purely appellate jurisdiction. No case cited by appellant is authority otherwise. To exclude from this rule the reviewing of plans of reorganization would be to cause untold confusion; the courts of appeals would be placed in the position of deciding issues "de novo" and would, in effect, change the whole procedure before such courts from review to original inquiries. The decisions cited by petitioner do not sanction such procedure, nor is it contemplated by the provisions of Chapter X of the Bankruptcy Act.

III.

IN ITS DETERMINATION THAT THE PROPOSED PLAN WAS FEASIBLE THE COURT BELOW CONSIDERED ALL THE REQUIREMENTS ESSENTIAL TO ESTABLISH FEASIBILITY, INCLUDING THAT OF ANTICIPATED EARNINGS FOR THE LIFE OF THE PLAN, AND THE PLAN MEETS ALL REQUIREMENTS OF FEASIBILITY NECESSARY UNDER CHAPTER X.

Whether a proposed plan of reorganization is feasible or not is a question of fact to be determined by the court after due hearings, and only in a case of clear mistake will the findings of the court below as to feasibility be set aside. As was said by the court in the case of *In Re Penfield Distilling Co.*, 131 F. (2) 694 (C. C. A. 6th), on page 694:

> "Findings of fact by a referee in bankruptcy, confirmed by the District Judge, will not be set aside, on appeal, on anything less than a demonstration of plain mistake."

In *Wayne United Gas Co.* v. *Owen-Illinois Glass Co.*, (C. C. A. 4th), 91 F. (2) 827, 831, the court said:

> "The findings of the court below with respect to the good faith of the debtor in the filing of the petition, *the feasibility of the plan therein proposed*, and the unfairness of that plan to first mortgage bondholders are findings of fact, which we will not disturb unless clearly wrong." (Emphasis supplied.)

The question of feasibility then resolves itself into whether there was "plain mistake" on the part of the court, and that it was "clearly wrong" in determining that the plan was feasible. Having asserted it, the petitioner has the burden of demonstrating that, in the light of the evidence, there is no reasonable possibility under which the plan could succeed. A review of the evidence adduced at the hearings, however, clearly shows that there was more than ample grounds to support the referee's and the court's determination of feasibility.

In arriving at his findings, the referee had before him the records of operations for the previous five years (Tr. 162); he had before him the testimony of Wilbur R. Haynie who had long experience in the reorganization of real estate bond issues, and in the operation and appraisal of real estate (R. 20-23); he had the testimony of Ivan W. Turnquist who had been in the real estate business for twenty-three years and had made appraisals for the H. O. L. C. (R. 40-43). The Referee was sufficiently informed to determine the amounts necessary to reasonably assure success of the plan, and the reasonable assurance that such funds would be available from the earnings of the property.

The test of whether a plan is feasible is not solely whether the corporation made expected profits in prior years. If this were true the relief for which Chapter X was evolved would be non-existent, since a debtor could never have a plan approved if its past earning record had not met expectations, and it is precisely for that type of debtor that Chapter X was brought into existence. *Consolidated Rock Products* v. *DuBois*, 312 U. S. 510, requires an inquiry as to *expected* earnings which may reasonably be anticipated for the life of the plan; where such an inquiry is made, and the Referee and the Court determine *after* such inquiry that the reasonably anticipatable earnings are ample to meet all requirements of the plan, the test of earning capacity as determinable of a plan's feasibility is met. The court must look to the future as to whether a plan has reasonable assurance of success—not merely to the past.

There can be no question but that the property's indicated net earnings will be sufficient to meet the interim requirements of the plan. The maturity of the first mortgage notes is extended to May 10, 1948, and on the basis of present and prospective earnings, interest payments can be met when due for the life of the extension. Under more adverse economic conditions, in the six years prior to the

filing of the petition herein, no default was made at any time as to interest payments, and it surely cannot be seriously contended that such payments cannot be met in the next six years. The Referee further found, and his finding was confirmed by the court, that not only $3500.00 per annum would be available for retirement purposes, but that there will be, in all probability, $36,000.00 available for amortization of bonds during the six year life of the proposed plan of reorganization (R. 107). Since no dividend payments are required by the plan, the test prescribed by appellant's authorities—that earnings be reasonably expected to meet interest and dividend requirements—is more than fully met by the plan.

It must be remembered that for some years in the past there has been no building of housing accommodations, except in a few isolated instances for war workers which type of housing is not in competition with the property here concerned, and that for an undetermined time in the future no such building will be resumed, and that it therefore can assuredly be reasonably expected that the present annual income should be maintained for the life of the plan. This is not using war earnings as the basis of determining whether the plan is feasible; it is merely determining that in the light of existing conditions and the foreseeable future, present earnings will at least continue until May 10, 1948, the termination date of the plan. The termination of the present war cannot immediately affect the income of this property since, as has been noted, the conditions permitting present earnings will persist for some time beyond the ending of the war. Furthermore, the court will note that rents, due to emergency legislation, have been frozen, and because of the prevalence of one year leases, the date applicable is usually October 1, or May 1, 1941. Without such legislation there is no doubt that rents would be considerably higher, and upon the lifting of such rent

ceilings, it may well be that rents would seek their natural levels and increase the income of the property even beyond present levels.

The fact that use of the present earnings as an indication of feasibility may not be sanctioned under some circumstances cannot be made the basis of a sweeping assumption that such earnings cannot, in other circumstances, be reasonably expected to continue for the life of a proposed plan of reorganization. As was said in *In Re Central Forging Co.* (D. C. M. D. Pa.), 38 F. Supp. 18, page 19:

> "In the determination of what is fair and equitable and feasible, the facts of each case must be considered, and cases which bear a superficial similarity may not present the same problem at all."

To the question, "Will the debtor be able to retire or refund the debt at the end of this second extension period?" the answer is that the evidence indicated it would; the Referee found it would; the District Court believed it would; the Circuit Court of Appeals believed it would. There need be no provision in the plan guaranteeing that creditors will be paid in full at the end of the period of extension. In the case of *In Re Gibson Hotels* (D. C. S. D. W. Va.), 24 F. Supp. 859, on page 864, the court said:

> "But in order for a reorganization plan to be feasible, it is not necessary that there should be some guarantee that the creditors will be paid in full, without question, within a specified period. Nothing in the statute requires such a guarantee. * * *"

The test is not absolute guarantee of success beyond any possibility of doubt; a reasonable belief is all that is required. On this point the language of the court in *Rauscher v. Northwest Cities Gas Co.*, 46 F. Supp. 49 (D. C. Ark.), on page 51, is pertinent. The court said:

> "My problem, however, is not to determine whether beyond peradventure the plan will succeed. My task

is to determine whether it probably can succeed. The word 'feasible' does not connote absolute assurance of success. It means reasonable assurance of success. * * * The only standard by which a reorganized Northwest's possibility of success may be appraised is the history of its operations in the recent past *in conjunction with the probable changes in conditions during the not too distant future.*" (Emphasis ours.)

Foreseeable future conditions, especially where a plan is to operate for a limited time, must be taken in consideration in determining the probable success of a plan. The life of the plan is until 1948. There is no reason to believe that, so far as can be foreseen, the same difficulties will beset the debtor for the life of the plan as were encountered in the past. It is precisely because of the present economic situation that the debtor sought to reorganize with the highly probable expectation of success, and such economic conditions as can be foreseen in the immediate future are largely in favor of the plan's feasibility.

Furthermore, where a plan is not unfair and not inequitable as a matter of law, and where only the factual question of feasibility is involved, the fact that an overwhelming percentage of creditors, the parties primarily concerned, consent to the plan, should be given considerable weight. Consents were filed herein by the holders of $107,100 of an aggregate amount of $123,600 of claims filed (R. 204). The only active objector is the petitioner who holds one $1,000 bond. The very spirit and purpose of Chapter X is to prevent a single recalcitrant party from blocking a plan deemed desirable by a tremendous percentage of creditors of the same class.

As was said by the Court in *In Re A. C. Hotel Co.* (C. C. A. 7th), 93 F. (2) 841, 843:

> "However, the expressed preference of a large percentage of all claims of security-holders interested in

the property, especially if well-considered and intelligently reached, should not be lightly set aside."

In the case of *In Re Gibson Hotels* (D. C. S. D. W. Va.), 24 F. Supp. 859, 864, the court said:

> "In passing upon feasibility of a reorganization plan a court should not lightly set aside express preference of a large percentage of all claims or interested security-holders, especially if well considered and apparently intelligently reached."

Upon the question of fact of feasibility, where due consideration has been given to all essential factors, including past earnings, probable future earnings for the life of the plan, the foreseeable economic future, and the reasonable probability of success; and where the Referee, the District Court, and the Circuit Court of Appeals have all determined the plan is feasible, certainly it cannot be said that the plan is, in fact, not feasible.

The language of the Court in *In Re 333 North Michigan Avenue Building Corporation*, 84 F. (2) 936 (C. C. A. 7th), on page 943, may be well appropriate here:

> "It is urged by appellants that the plan is not feasible. That, of necessity, must depend upon the earning power of the property and future economic conditions. * * * What the property is, and what it has produced, is well known. What it will do in the future is, of course, problematical. The District Court held that there was reasonable ground for believing the plan would succeed. We concur in that view."

IV.

THE NECESSITY OF AN INDEPENDENT, FORMAL APPRAISAL IS WITHIN THE SOUND DISCRETION OF THE TRIAL COURT, AND WHERE THE DEBTOR'S PROPERTY CONSISTS OF A SINGLE PARCEL OF REAL ESTATE, AND THERE IS SUFFICIENT VALUATION DATA IN THE RECORD TO ENABLE THE COURT TO EXERCISE AN INFORMED JUDGMENT, IT IS JUSTIFIED IN CONFIRMING A PLAN WITHOUT REQUIRING AN INDEPENDENT APPRAISAL.

Whether or not the court should order an independent appraisal at the expense of the estate depends upon the facts of each proceeding. If the Referee or Court finds that without such an appraisal it cannot exercise its own informed, independent judgment then without question such an appraisal is entirely appropriate. It may well be that in the case of a complex, diversified enterprise an independent appraisal of a formal nature is essential, but where the enterprise involved is a single piece of property, and where sufficient information of a reliable nature is available, no such appraisal is necessary. Indeed, such appraisal may properly be held to be wrongful in adding another burden of expense to an already overburdened debtor.

This view is supported by this court in its holding in the case of *Consolidated Rock Products Co.* v. *DuBois,* 112 U. S. 510, 527. The Court said:

> "The Circuit Court of Appeals correctly left the matter of a formal appraisal to the discretion of the District Court. The extent and method of inquiry necessary for a valuation based on earning capacity are necessarily dependent on the facts of each case."

There is no basis for the contention that a formal appraisal of the property must be submitted to the court before it may approve a plan to be submitted to the creditors.

No authority to sustain this view is cited. So long as before the plan is confirmed by the court there is competent valuation data upon which the court can base an informed opinion, the requirements of the statute are satisfied.

Competent testimony was submitted by three appraisers as to the valuation of the debtor's property, ranging from $139,550 by the appraiser for the petitioner, to $155,000 by the appraiser produced by the Indenture Trustee. The appraiser for the petitioner arrived at his valuation by capitalizing earnings at from 8% to 9%, but admitted that if a buyer would take 7% for his investment, his valuation would be higher (R. 33). Mr. Turnquist, appraiser for the debtor, testified that the proper rate of return for a prudent investor on this type of property would be 5% to 6% (R. 43). The Referee in determining the economic value of the property used the very test of expected earning capacity which petitioner contends is the primary test sanctioned by this Court. It was not incumbent upon the Referee to accept the valuation submitted by any one or more of the appraisers, and he had not only the right, but the duty, to independently determine, from all available information in the record, the proper valuation based upon expected earning capacity, and upon what he independently determined to be a fair rate of capitalization. He had the right to consider that rents are currently frozen by present war time legislation in determining the factor capitalizing earnings when considering present income; and the likelihood of a lower rate being currently applied due to such frozen rentals in anticipation of a general rental increase when rent ceilings are lifted.

The Referee in his report stated:

> "That taking everything into consideration, *and based on what I regard at this time a fair capitalization of the prospective earnings of the debtor's real estate*, such real estate would have an economic value of at least $160,000." (R. 163.) (Emphasis supplied.)

On the question of the necessity of a formal appraisal the Circuit Court of Appeals in *In Re Georgian Hotel Corporation* (C. C. A. 7th), 82 F. (2) 917, on page 920, said:

> "Appellants assume to find impropriety in the fact that, prior to the adoption of the plan, no definite formal appraisal of the property was made. * * * There was testimony given as to the status of the property, the original cost of the plant, its probable replacement cost, the income derived and charges and upkeep, and other matters having direct bearing on the value of the property, and its future prospects. Such evidence was informative and helpful to the court in the exercise of its discretion. In view of the circumstances pointed out, the absence of a formal appraisal was not such an omission as should of itself condemn the plan."

The Referee in this proceeding had before him all necessary data, including probable earning capacity, to arrive at an informed judgment as to the value of the debtor's real estate (R. 160-163), and the court in confirming such valuation exercised a sound discretion.

V.

THE RECORD DISCLOSES NO CONFLICTING INTERESTS OF THE INDENTURE TRUSTEE, NOR FAILURE TO MAKE A COMPLETE DISCLOSURE OF ITS ACTIVITIES, AND THE HOLDING OF THIS COURT IN AMERICAN UNITED MUTUAL LIFE INSURANCE COMPANY v. CITY OF AVON PARK, 311 U. S. 138, HAS NO APPLICATION TO THE INDENTURE TRUSTEE HEREIN.

The only basis offered for any allegation that the Trustee Indenture occupied any such position as to require a delving into its activities with a view towards its removal is the fact that it owns a small percentage of the bonds in its individual capacity and in its capacity as trustee under certain trusts. We fail to see wherein the mere ownership of a small portion of the bonds will cause the trustee to be miscreant to its trust. The trustee's duties have always

been in behalf of the owners of the bonds, and the trustee never had and has not now any interest, financial or otherwise, to any others; it at no time had any obligation to anyone except bondholders. Indeed its ownership of some of the bonds makes its interest identical with the bondholders and may have even caused it to be more astute and cautious in protecting their interests.

No personal gain or advantage derived by the Indenture Trustee by the alleged activities and alleged non-disclosure is even remotely shown. The record shows by the sworn statement of the trustee that it held the notes owned by it for more than one year prior to May 10, 1942, so that there is no basis for the allegation that these bonds may have been purchased prior to the filing of these proceedings for the purpose of expediting the extension of the bond issue (R. 85-86). Nor did the activities of the committee in any way prejudice the rights of the bondholders. The letters asking for deposit were frank and open and fully disclosed the situation, and the bondholders were later informed that, due to the requirements of the Securities Act of 1933, the deposit agreement was revoked, and the members would act as attorneys in fact if so requested (R. 90-91).

The underlying objection to the Indenture Trustee's activities is that it approved the plan herein proposed, and lent its aid to its adoption. The plan was filed by the debtor corporation, although it is not denied that it was approved by the trustee which is agreeable to its consummation. If the plan is approved by the Trustee who believes it fair and workable, is there any reason why it should not consent to its confirmation? It may file a plan of its own if not satisfied with other plans submitted, but that is not to say that it cannot urge approval of a plan offered by the debtor which, in its opinion, is worthy of adoption, and is fair and equitable to all creditors. There

is but the lone assertion by a single objecting creditor that the plan is unfair and unfeasible, and that therefore approval of such a plan by the Indenture Trustee is tantamount to reprehensible conduct—an assertion which on its face reveals its inherent invalidity.

The case of *American United Mutual Life Insurance Company* v. *City of Avon Park*, 311 U. S. 138, upon which petitioner heavily relies as sustaining his contention as to the alleged non-disclosure on the part of the Indenture Trustee, is in no way analogous to the situation here. That case dealt with the disclosure to be made by a fiscal agent seeking approval of a plan worked out by it, and in which it actively attempted to secure consents. The court found that the fiscal agent had at least three financial stakes in the composition arrangement, if it were approved, and that without claims held by the agent and voted by it in favor of the plan, the necessary two-thirds consent would not have been obtained. In the present proceeding, however, the relationship of the Indenture Trustee to the bondholders was known to all concerned. The only financial interest the Indenture Trustee has in this plan, other than as owner of some of the bonds, is the usual compensation it may receive as such trustee. Surely the fact that it did not affirmatively notify each bondholder that it did and would receive such compensation is no basis for contending such non-disclosure as may be to the prejudice of the creditors. It is common knowledge that a bank acting as trustee under an indenture receives compensation therefor, and that such compensation is merely in payment for services rendered; furthermore, the trust indenture provided for such compensation (R. 76). Any corporate trustee acting in such capacity exacts the same fees, and it can safely be assumed that all the bondholders were well aware of such fact. Merely receiving such compensation is a far cry from having a personal financial stake in the plan itself, and in

securing definite financial benefits accruing from the provisions of an agreement between the debtor and the fiscal agent if the plan is approved, as was the situation in the City of Avon Park case. Furthermore, even without the bonds held by the bank, over 70% in amount of the owners of the bonds have individually signed consents to the plan of reorganization (R. 167).

Nor does the case of *Woods* v. *City National Bank & Trust Company of Chicago,* 312 U. S. 262, cited by petitioner, apply to the situation in the present proceedings. That case dealt with fees claimed by various parties, and it was merely held that where such claimants represent conflicting interests compensation will be denied. The conflicting interest which the court held reprehensible was that the committee which solicited the bondholders was composed of employees of the principal underwriters who were heavily interested in the equity. The Indenture Trustee herein, however, has no interest in the equity whatever, merely being a creditor to the extent of its ownership of the bonds of the debtor, and represents no conflicting interest of any nature.

The propriety of the type of inquiry demanded by petitioner, and the removal of the Indenture Trustee were certainly at most within the sound discretion of the trial court. Indeed, upon the record, with its complete lack of evidence of any kind of any misconduct, bad faith, or personal advantage on the part of the trustee, it would have been an abuse of discretion by the court to have so ordered. The case of *In Re Georgian Hotel,* 82 F. (2) 917 (C. C. A. 7th), while it dealt with the question of reorganization trustees and not indenture trustees, indicates the attitude of the court. On page 920 the court said:

> "Much is said in appellant's brief on the subject of the personnel of the original bondholder's committee and of its successors and of the trustees who are sug-

gested in the plan to take charge of the reorganized concern. * * * Again we fail to see wherein the court in this respect abused its discretion. If the trustees who may be constituted under the plan are recreant to their trust and fail to discharge their duties, anyone interested may, on application to the court, have an investigation and such relief as the nature of the case may require."

Certainly more is necessary to warrant an investigation and removal of an indenture trustee than a mere demand by a single objecting creditor, who has no evidence to offer in support of his demands, and who makes no showing whatsoever of any conflicting interests, bad faith, or prejudicial conduct.

VI.

IT IS NOT ERROR FOR A COURT TO REFUSE TO MODIFY A PLAN OF REORGANIZATION TO PROVIDE FOR AN OUTRIGHT SALE OF THE PROPERTY, WHERE THE ORIGINAL PLAN IS FAIR, EQUITABLE AND FEASIBLE AND HAS BEEN APPROVED BY AN OVERWHELMING PERCENTAGE OF THE CREDITORS.

The question involved in the present proceedings is not whether the court had the authority, under Chapter X, to provide for a sale of the property at an upset price; rather it is whether the court was in error in refusing to modify the plan to provide for such a sale. The holding of the court in *Fidelity Assurance Association* v. *Sims*, 318 U. S. 608, is neither expressly nor impliedly involved here. There can be no contention that it is incumbent upon a court, when an objector to a plan desires it modified so as to order a sale of the property, to perforce immediately set aside the proposed plan and put in effect the proposed modification. The plan as confirmed by the court was fair and equitable to all; it contemplated the continuation of the enterprise for the benefit of all concerned; it provided a

fair rate of return for the creditors; it was approved by an overwhelming percentage of all the security-holders.

Where a proposed plan effectively secures the reorganization of a debtor corporation with all probability of the carrying out of the plan to successful completion, there is no need to modify the plan to one in which outright liquidation is contemplated. While it may be true that the Sims case does not prohibit a sale under a plan of reorganization, it is certainly not authority that a plan must involve a sale; the Referee undoubtedly considered that the plan adopted was more advantageous to all concerned than a liquidation, and that there was no need to give full consideration to a plan requiring the sale of the property.

Conclusion.

We conclude:

1. A plan of reorganization of a solvent corporation which permits stockholders to participate only to the extent of their equity, and which provides for an extension of the maturity date of outstanding bonds and provides for an interest rate equal to the return the bondholders received prior to the filing of the petition, is fair and equitable and does not violate or contravene the "absolute priority" rule. No holding in any case requires the rate of interest fixed in the bonds as payable after maturity to be the rate of interest which must be included in a plan, if stockholders participate, where the maturity date of the bonds is, under the plan, extended for a period of years.

2. The Circuit Court of Appeals is, under the Bankruptcy Act, a court of appellate jurisdiction only, and except where modified by statute the same rules of appellate procedure apply to appeals under the Bankruptcy Act as in any other case. Thus, where a specific objection to a plan of reorganization is not raised before the Referee on the District

Court, the objector is precluded from raising such objection for the first time on appeal.

3. Under the plan of reorganization herein, interest on the outstanding bonds has been afforded the same priority as the principal, and payment of all interest have been met on each due date.

4. In its determination that the proposed plan was feasible the court below considered all the requirements essential to establish feasibility, including that of anticipated earnings for the life of the plan, in accord with all decisions of this court and the requirements of Chapter X of the Bankruptcy Act.

5. The necessity of an independent, formal appraisal is within the sound discretion of the trial court, and where the debtor's property consists of a single piece of property and there is sufficient valuation data of a reliable nature before the court, there is no abuse of discretion in not requiring such an independent appraisal.

6. The record discloses no conflicting interests of the Indenture Trustee, and there has been no showing of any activities or alleged nondisclosure which could possibly prejudice the creditors.

7. The question as to whether the holding in *Fidelity Assurance Association* v. *Sims,* 318 U. S. 608, prohibits a plan from providing for the sale of the debtor's property at an upset price, is not here involved.

The judgment of the Circuit Court of Appeals for the Seventh Circuit is not in error; it is not in conflict with the decisions of the Illinois courts or of any other circuit; it is not in conflict with any decision of this court. The decision is in complete accord with all principles of corporate reorganization as reported by this court and the

various Circuit Courts of Appeals and District Courts. Hence the petition for certiorari ought to be denied.

Respectfully submitted,

Walter E. Wiles,
Counsel for Respondent, Chicago City Bank & Trust Company, Indenture Trustee.

Herman Barrington,
of counsel.

BRIEF FOR THE RESPONDENTS IN OPPOSITION

(28)

IN THE

Supreme Court of the United States

October Term, 1944.

No. 1024

In the Matter of
WAERN BUILDING CORPORATION,
Debtor.

ERNEST MORRILL,
Petitioner,
vs.
WAERN BUILDING CORPORATION,
Respondent.

BRIEF IN OPPOSITION OF WAERN BUILDING CORPORATION TO PETITION FOR WRIT OF CERTIORARI OF ERNEST MORRILL, PETITIONER.

To the Honorable, the Chief Justice and Associate Justices of the Supreme Court of the United States:

Now comes Waern Building Corporation, debtor and respondent, and moves the court for leave to adopt the brief in opposition heretofore filed by Chicago City Bank & Trust Company, Indenture Trustee, respondent, to petition for writ of certiorari of Ernest Morrill, petitioner, and that same stand as and for the brief in opposition of Waern Building Corporation, debtor and respondent to the said petition for writ of certiorari of Ernest Morrill.

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REPLY BRIEF

(24)

IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1944

No. 1024

In the Matter of

WAERN BUILDING CORPORATION,
Debtor.

ERNEST MORRILL,
Petitioner,
vs.
WAERN BUILDING CORPORATION,
Respondent.

REPLY TO BRIEF OF RESPONDENTS IN OPPOSITION.

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WAERN BUILDING CORPORATION,
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Respondent.

REPLY TO BRIEF OF RESPONDENTS IN OPPOSITION.

The brief of the Respondents in opposition to the Petition for Certiorari, predicated as it is upon certain fundamental misconceptions of both law and fact, constitutes, it is respectfully submitted, no answer to the position of petitioner.*

* The brief is denominated "Brief of Respondents in Opposition", using the plural. The court will notice, however, that the brief is filed on behalf of only one respondent, *Chicago City Bank & Trust Company, Indenture Trustee.* The principal respondent, Waern Building Corporation, has not, up to the present writing, filed any brief of its own in opposition.

I.

Under Point I of Respondent's argument it is assumed that the stockholders of the debtor corporation were allowed to participate, under the plan of reorganization, because they possessed an equity, and it is assumed, moreover, that the bondholders were afforded every right which they had prior to the confirmation of the plan (Respondent's Br. 6, 7, 8). Whether or not the stockholders of the debtor possessed the thin margin of interest claimed for them under the unscientific testimony of the expert witnesses called to support the plan, in no manner touches the right of the bondholders to receive the full priority to which they are entitled under the terms of their bonds and under the trust indenture securing them.

The bare statement of the admitted facts will demonstrate the insufficiency of the admittedly precarious foundation of the stockholders' claim to an interest or equity in the debtor's assets. The property, a furnished apartment building, is now approximately 17 years old and, for the most part, has never been refurnished (R. 29). One witness for the Respondents, testifying as to value, was an employee of the same Respondent which submits herein the opposing brief. He had no experience as a real estate valuator (R. 21), and he testified that on the morning of the day on which he was called as a witness he "saw" the building. There is no evidence that he made any true examination either of its exterior or interior or that he based his opinion on its earning capacity (R. 21). This was Wilbur C. Haynie who stated that in his opinion the property had a cash market value of $155,000.00 The only other witness called by the supporters of the plan, and who makes any claim to expertness, was Ivar W. Turnquist, who testified that on the basis of original cost,

less depreciation, in his opinion the property had a value of $150,000.00. Turnquist, too, was probably produced by the active Respondent to the instant petition (R. 41). The witness, Frank M. McKey, called by petitioner, testified that, based upon earning capacity, the property, in his opinion, possessed a value of $139,550.00. This would render the debtor insolvent and would deny the stockholders participation in the plan. McKey was the only appraiser who observed that "meticulous regard for earning capacity" prescribed by this court as essential to the determination of the feasibility of the plan as well as its fairness. (*Consolidated Rock Products*, 312 U. S. 510, 525.)

Even if the Turnquist appraisal of $150,000.00, made upon the cost-less-depreciation basis, be accepted for the purpose of argument, there will be found to be no considerable residuum of equity for the stockholders. The principal indebtedness to the bondholders totals $141,800.00, leaving an over-plus of only $8,200.00 to take care of all the costs, fees and expenses of reorganization. If the valuations of the only two appraisers (McKey and Turnquist) who conducted any actual examination of the property be averaged at the point midway between the opposing appraisals, it will be found that the property would possess a value of $142,775.00, leaving $975.00 for the equity. Nothing is considered for replacement of equipment. It should be noted, in passing, that the Referee's statement that the property possessed an economic value of $160,000.00 finds no support whatsoever in the record (R. 163). Viewed realistically, it is self-apparent that no bank or other lending agency would make a loan of $141,800.00 on the property under any valuation appearing in this record.

While the foregoing consideration of the alleged equity in the stockholders is unnecessary to the enforcement or application of the full priority rule, it may serve as a back-

ground against which the rights of creditors may be observed.

The error into which the Circuit Court of Appeals fell was induced by the same argument which is now made to this Court, namely, that the creditors will receive 4½% interest under the plan and will receive as much as the *average rate* which they received under the old indebtedness. There were three rates of interest payable at three different periods under the terms of the bonds held by the creditors. One rate was 4% per annum from 1936 to 1939, another was the rate of 5% per annum from 1939 to 1942, and the third was 7% per annum after May 10, 1942, or, in other words, after maturity. *At the time the indebtedness matured and for three years prior thereto, the bondholders were entitled, not to an average of the interest receivable over the entire period of the indebtedness, but to the full rate of 5% a year.*

To average the interest rate is to re-make the contract of the parties. Debtor says bondholders will get the average of what they formerly received. That is not the test of fairness. That period is passed. The contract provides what they are entitled to receive after May 10, 1942—7% interest—and unless they receive that interest rate, they are not given full compensatory treatment in accordance with their contract. It is idle to argue, therefore, that the rights of the creditors are not being cut down, and to contend that no payment of dividends or other participation will be allowed to the stockholders until the bondholders are paid. *By this plan of reorganization the bondholders are deprived, immediately, of the full rate of interest to which they were entitled even prior to the maturity of the debt.* The court below, as do counsel for Respondents here, first reduced the interest rate and then contend that on the cut-down basis the bondholders will be paid first. The flaw in the argument is that it ignores

the point that the bondholders, by contract, were entitled to 7% interest after maturity and 5% interest before maturity. Of course, whatever is not paid to the bondholders is necessarily retained by the debtor itself, and if, unlikely as is such an eventuality, the debtor will some day pay this obligation in full, under the plan it will pay less to creditors in the total of principal and interest, than it was obliged to pay under the contract, before the present plan of reorganization. The stockholders participate in direct proportion to the amount by which the debtor is relieved from payment.

Aside from its unfairness, the danger of applying the scheme of averaging interest rates is apparent. Assume, for example, that a debtor, under an original bond issue, was obligated to pay 2% for the first three years, 4% for the next three years, and 6% for the last four years of a ten year period of indebtedness. Under the theory of the Court of Appeals a plan of reorganization providing for an average rate of interest of 4-1/5% would constitute full payment and priority to bondholders who for four years preceding maturity were entitled to 6% interest. If this same formula be applied to indebtednesses of greater magnitude, hundreds of thousands of dollars could and would be transferred from creditors to debtors.

Many specious arguments are addressed to the court in support of the Respondents' position. Such, for example, is the contention (Respondents' Br. 6) that the plan "allows them (the bondholders) the same return under the proposed extension as they received in the previous period." As has been said, the period immediately previous to the confirmation of the plan (from May 10, 1942 to Nov. 8, 1943) required 7% and not 4½% interest, and the period immediately preceding the date of maturity required 5% interest. Inadvertently, Respondents admit the position of the petitioner when it is said in their brief (page 7): "It

is only where participation by stockholders is permitted in excess of what is determined to be their equity, *or where the creditors are deprived of the full compensatory rights which they formerly enjoyed, and there is some scaling down of their interests in favor of stockholders that the priority rule is violated.*" (Italics ours.)

The attempted criticism of petitioner's citation of the Illinois cases holding that creditors are entitled to interest at contract rates is wholly untenable. Respondents state that these Illinois cases merely hold that the mortgagee, upon foreclosure, is entitled to interest on the mortgage note at the contract rate from the date of the note until the rendition of the decree of foreclosure (Respondents' Br. 7). Foreclosure, of course, is merely one of the remedies exercisable by the creditor, and under it the court proceeds to enforce the contract of the parties as such contracts are written just as the court is required to award judgment under the terms of the contract if suits were commenced upon the notes or bonds themselves.

The opinion of the Court of Appeals is in direct conflict with Illinois law which recognizes and enforces a contract obligation providing for the payment of interest at the rate of 7%. Moreover, a corporation may legally contract to pay *any* interest rate. Chapter 74, Section SEC 4 (Interest), Illinois Revised Statutes (1943), State Bar Association Edition provides:

> "In all written contracts it shall be lawful for the parties to stipulate or agree that seven (7) percent per annum, or any less sum of interest, shall be taken and paid upon every One Hundred (100) Dollars of money loaned * * * provided, however, with respect to money loaned to or in any manner due and owing from a corporation, the parties may stipulate or agree upon *any* rate of interest whatsoever. * * *" (Italics ours.)

Respondents' argument, moreover, that this court, in the *Milwaukee* case, 318 U. S. 573, and in the *Consolidated*

Rock Products case, 312 U. S. 510, "merely holds that interest on secured claims could not be cut off or wiped out any more than the principal if junior securities participate" (Respondents' Br. 8) again, in effect, concedes the correctness of petitioner's position. Respondents would restrict the word "participation" to present participation in the net income. As has been heretofore argued, stockholders here participate by electing directors who will manage the property of the debtor, and who will make leases, determine and govern operating costs and otherwise completely control the business. After all, the stockholders are the equity holders of the corporation. They, through their directors, control legal title. The corporation, for the purpose of reorganization, is the stockholders in their combined form, and it is the corporation which is relieved of part of its obligation under the present plan.

The underlying questions here are: Do the bondholders possess the right to receive 7% interest after May 10th, 1942? The answer, under the terms of their contract, must be in the affirmative. And, did the bondholders possess the right to receive 5% interest prior to maturity? Here, too, the answer must be in the affirmative. It follows inevitably, therefore, that their rights were violated by the plan of reorganization confirmed by the District Court.

The decision of the Court of Appeals below, if allowed to stand unreviewed and unquestioned by this court, may have far reaching consequences and may provide a pattern for future plans of reorganization where the results of the precedent may be quantatively more violative of the full priority rule than the plan in the instant case.

The question involved in this appeal is also vital in the administration of the reorganization provisions of the Bankruptcy Act. Under 77B, many bond issues involving real estate were extended. Many of these issues are again maturing and equity owners will undoubtedly again seek

relief in the federal courts. In Illinois, virtually all bonds and trust indentures provide for interest at 7% after maturity. As observed above, the rate is valid and is expressly authorized by Illinois statute. Under a plan of reorganization, may a debtor extend the maturity date of a debt, reduce the rate of interest fixed by the contract to an average rate previously paid, and at the same time participate in the plan? The District Courts will need guidance. The problem is of prime importance in federal reorganization law.

II.

The decision of the Court of Appeals, here sought to be reviewed, escaped, rather than decided, the important question presented to it for decision. The court was in agreement apparently only on the point that an objection specifically mentioning the full priority rule and completely outlining the position of petitioner should have been presented to the District Court. The petitioner did object to the plan on the basis that it was not fair or equitable and that it was not feasible. With due respect for the learned Judges below, it is submitted that the evasion of the principal point made upon the appeal was based upon a misconception of the true function of the District Court in a reorganization proceeding.

Respondents argue (Respondents' Br. 9) that petitioner's position is that in a reorganization proceeding the scope of the Circuit Court of Appeals jurisdiction is broader than in the case of ordinary litigation. Such is not petitioner's contention. The point which petitioner here seeks to make is that the Circuit Court of Appeals itself erred in refusing to review the action of the District Court. Whether or not, in such cases, an objection that the plan is not fair, equitable and feasible is sufficient, even though not complete in

every formal and technical aspect, presents a question of extreme importance in reorganization proceedings.

Regardless as to whether or not a formal and technically specific and complete objection was made to the plan on the basis of the full priority rule or, indeed, whether or not any objection at all was presented, the District Court was under the duty of protecting the rights of all creditors and others. The full performance of such duty required the court to perceive that, under the undisputed facts, a plan providing for an interest rate based upon averaging the entire period preceding maturity, which resulted in a new interest rate under the plan, less, even, than that which the debtor was obliged to pay before maturity, while at the same time allowing the stockholders an interest and participation in the corporate enterprise, necessarily contravened the repeatedly announced mandate of this court.

The Bankruptcy Act places upon the District Court a duty transcending its usual function as a judicial umpire. (Sec. 174 and Sec. 212 of Ch. X of the Bankruptcy Act.) From the very nature of reorganization proceedings, the court is required to do more than is usually necessary in causes involving contending litigants. As Mr. Justice Douglas said in the *Los Angeles Lumber Company* case, 308 U. S. 106, at pages 114-115:

> "The court is not merely a ministerial register of the vote of the several classes of security holders. All those interested in the estate are entitled to the court's protection. Accordingly, the fact that a vast majority of the security holders have approved a plan is not the test of whether the plan is a fair and equitable one * * * * A contrary conclusion in such case would make the judicial determination on the issue of fairness a mere formality and would effectively destroy the duty imposed by Congress on District Courts under Section 77B * * *. 'Every important determination by the court in receivership proceedings calls for an independent judgment.'"

Finletter, in "The Law of Bankruptcy Reorganization", says at page 474: "The court in effect is the guardian of those who do not assent to the proposal—a minority whose contract with debtor is being converted into some new and different right, protected only by the 'satisfaction' of the court."

The effect of the opinion of the Court below is to penalize, not alone the petitioner, but an entire class of bondholders, who own over $140,000.00 of the bonds. It is the function and duty of the District Court to protect the entire group of security holders.

In reorganization cases the judge is the boss of the reorganizers—not a mere dignified figure, passing only upon such questions as are forced upon his attention by vigorous counsel. Perhaps in a great majority of cases bondholders do not have lawyers. They receive communications from trustees, from creditor's committees and from banks, around the name of which is an aura of responsibility, recommending plans of reorganization. Consents from the uninformed and unpracticed security holders flow in as a matter of course. It was in realistic appreciation of such practical factors that Congress imposed upon the District Courts a duty somewhat larger and a vigilance somewhat sharper than is usual in the ordinary exercise of the judicial function. The court below failed to observe that such duty and vigilence do not come into being only under the pressure of objection.

III.

In Point III of petitioner's brief in support of his petition for certiorari, it was argued that the courts below disregarded the test of feasibility laid down by this court to the effect that the debtor's earning capacity is the most important criterion in determing feasibility. It was pointed

out (petitioner's brief Page 14 *et seq.*) that this court has said that whether or not earnings may reasonably be expected to meet interest and dividend requirements of the new securities is the *sine quo non* to the determination of the integrity and practicability of the new capital structure. And this court has said that the necessity for such an inquiry is made the more necessary by a past record of poor earnings (*Consolidated Rock Products* v. *DuBois,* 312 U. S. 510, 525, 526). Furthermore, in a recent case, the court pointed out that it cannot be assumed that the figures of war earnings can serve as a test for the indefinite future; that it is known from past experience that the upswing of business induced by war is likely to be followed by an aftermath in which conditions may be worse than before; that "the bulge of war earnings, *per se*" is unreliable for use as a norm unless history is to be ignored; and that numerous other considerations, present here as in former periods, make them suspect as a standard for any reasonably likely future, normal year. *Milwaukee Railroad* case, 318 U. S. 523, 543.

It would seem that the court must be impressed with the negative, hesitant statement of the opinion of the Court of Appeals when it said: "Though the ratio of debt to the value of the property will be high, *it will not necessarily be so high* as to make some new financial arrangement *impossible or so improbable* that we may say as a matter of law that the plan is not feasible (R. 238). This statement, it will be observed, came after the discussion by the court of the evidence as to the feasibility of the plan. If a court were moved to approve plans of reorganization because they are not shown to be impossible or improbable of success, then any plan which has the good fortune to receive the recommendation of a referee is approvable and confirmable. What is contended here is that the Circuit Court of Appeals, in reviewing the action of the Referee and the District Judge, did not observe the normal earning

capacity test of feasibility in passing upon the action of the District Court. In such cases there is sometimes a vicious pyramiding of error. The district judge will not change the findings of the referee if there is any basis whatsoever, however weak, for such findings, and the Circuit Court of Appeals will refuse to review the action of the district judge, as to the facts, upon the ground that the lower court is best qualified to find the facts, having the opportunity to observe the witnesses testifying on behalf of the several contenders. The District Judge had the same cold facts and figures before him as the referee and the Court of Appeals was similarly situated.

In the opinion of the court below the effect of complete occupancy of the debtor's property due to a shortage of habitable quarters in defense areas, is set out in a table (R. 235). In 1938 and in 1939 the gross rents received was $28,000 and $28,100 respectively, while the respective operating expenses were $15,000 and $14,800. In 1943 the gross rentals (designated as a "crude figure") were $33,000 with the operating expense $16,000. Thus will be seen an increase in rents of approximately $5000 in 1943 over 1938—an increase in income of approximately eighteen per cent.

The plan under consideration requires the debtor to retire $3,500 in bonds annually. The debtor has never in any past period been able to meet this requirement. From 1928 to 1936, $8,000 in bonds were retired, or an average of $1,000 per year. From 1936 to 1942, $15,200 in bonds were retired at a cost of $11,443.25 (R. 45). During the entire period of 14 years, $21,200 in bonds were retired, or an average amount of $1,500 per annum. How does the debtor propose to achieve in the future what it has failed to accomplish in the past? As pointed out in our original brief (P. 19) retirement of debt, even if the plan succeeds, will be substantially less than normal de-

preciation of the property. Furthermore, as pointed out, the 77B plan failed by over $5,000 in debt retirement.

The debtor declares that with the elimination of the rent freeze, "it may well be that the rents would seek their natural levels and increase the income of the property even beyond present levels." What is the "natural" level of rents on the property in question? Its record of earnings over the first fourteen years of its existence (1928 to 1942) conclusively demonstrates that its earnings were insufficient to fulfill the requirements of the present plan. There is nothing in the forseeable future and nothing in this record which justifies the naive optimism of the proponents of the plan. Moreover, no answer is made by respondents to petitioner's point (Petitioner's Br. 20-21) that there is nothing in the past record of the enterprise which indicates that the Debtor will be able to retire or refund the debt at the end of this proposed, second, extension period.

Respondents argue that it is not the past earning record alone which determines future earning capacity. As this court has said, however, the poor earnings record of an enterprise in the past makes all the more essential a close examination of reasonably anticipatable earnings. It is undisputed that the debtor enterprise, in fourteen years of its existence has never been able to earn enough to satisfy the requirements of its funded indebtedness. This is the second trip to the courts for relief and reorganization. The same management will continue to operate. The business conducted by the debtor is a furnished apartment building requiring close management and constant service to the guests or tenants. One very large capital element, *i.e.*, equipment, was completely ignored by the sponsors of the plan. Haynie, employed by the indenture trustee, merely testified that he "saw" the building, giving the court no information as to the condition of the equipment. Turn-

quist (appraiser for debtor) testified (R. 41) that he had "no opinion as to the value of the furniture at the present time" and that he didn't have an opinion as to the remaining life of the furniture in the building. McKey, the only witness who testified to the equipment necessary to operate a furnished apartment building, said that while the building "is in wonderful condition as far as cleanliness is concerned," stated that he thought that the "building had been starved as far as maintenance is concerned." Furthermore, he testified that he would say that the greater portion of the furniture and carpeting "was in there when the building was built." "Within the next five years," he said, "most of it would probably have to be renewed if you are going to build the building up to what you call a first grade building" (R. 29).

Based upon the factor of essential equipment alone, it is difficult to perceive how the court could accurately estimate probable future earning capacity or earnings which may reasonably be anticipated. While quoting general figures of income and expense there is nothing in the record which indicates that the Referee and the District Judge were given that detail of information which is necessary soundly to appraise the future. Even in one of the cases cited by respondent, *Rauscher* v. *Northwest Cities Gas Co.*, 46 Fed. Sub. 49 (D. C. Ark.), the court said: "The word 'feasible' does not connote absolute assurance of success. *It means reasonable assurance of success.*" (Italics ours.) (Respondent's Br., 15-16.)

Appealing to this court as they appealed to the court below, the respondents urge that consents were filed herein by the holders of $107,000.00 of an aggregate amount of $123,600.00 of claims filed. The unpaid bonds, however, total, in principal amount, $141,800.00. The only active objector, say the respondents, is the petitioner, who holds one $1000.00 bond. (Respondent's Br., 16.) The small

interest of the objector, coupled with the large percentage of consenting creditors, is urged upon this court, as it was below, as a controlling factor in considering the objections of petitioner to the plan. This argument runs directly counter to the decision of this court in *Los Angeles Lumber Company*, Case 308, U. S. 106, where Mr. Justice Douglas delivering the opinion of the court said at page 114:

> "It should be stated that where a plan is not fair and equitable as a matter of law it cannot be approved by the court even though the percentage of the various classes of security holders required by Section 77B (f) for confirmation of the plan consented. * * *
>
> Hence, in this case, the fact that 92.81% of the amount of bonds, 99.75% of Class A stock, and 90% of the Class B stock have approved the plan, *is as immaterial on the basic issue of its fairness as is the fact that the petitioners own only $18,500.00 face amount of a large bond issue.* * * *" (Italics ours.)

In the *Los Angeles Lumber Company* case the $18,500.00 of bonds owned by the petitioners constituted a smaller fraction of the total indebtedness than the $1000.00 bond owned by petitioner here. The argument, of course, is an argument of convenience. Approached from a practical standpoint, it is well known that consents to plans of reorganization by widely scattered creditors are the product of well oiled machinery of banks and trust companies and creditors' committees experienced in the business of reorganization.

We have examined all of the decisions cited by the Indenture Trustee under its Point III. In the light of the tests prescribed by this Court in the *Los Angeles Lumber* case, 308 U. S. 106, and *Consolidated Rock Products Co.* v. *Dubois*, 312 U. S. 510, none of the Respondents' cited cases (all decided before *Los Angeles Lumber* and *DuBois* cases) is pertinent or applicable here.

IV.

The practice of the courts in procuring independent appraisals, or any appraisals, *after* the plan has been submitted to creditors for approval should be condemned. The burden of respondent's argument in answer to petitioner's Point IV, to the effect that the District Court should have appointed a competent and disinterested appraiser to evaluate the property in advance of the submission of the plan to creditors, is that "so long *as before the plan is confirmed* by the court there is competent valuation data upon which the court can base an informed opinion, the requirements of the statute are satisfied." (Respondent's Br. 19.)

Section 174 of Chapter X of the Bankruptcy Act provides that "the Judge shall enter an order approving the plan or plans * * * which are fair and equitable and feasible * * *." This means that the court must exercise an independent judgment. The statute contemplates a hearing on plans *before* submission. A "hearing" presupposes such a disclosure of facts as will determine whether or not the plan is fair, equitable, and feasible. How, it may be inquired, can the court exercise an informed and independent judgment without enough information to enable it to say that the plan sufficiently appears to be fair and equitable and feasible as to entitle it to submission to them whose consents must be obtained? To say, as do the respondents here, that it is enough for the court to acquire such information prior to confirmation, is to nullify the purpose of the statute in requiring a hearing before submission. Such an impractical and far-fetched construction of the Act gets the cart before the horse. In effect, the respondents contend that the plan should be submitted to the creditors, the consents obtained and *thereafter examined to ascertain if the plan should have been*

submitted and should have been consented to by the creditors.

If creditors do consent they are moved largely by the persuading stamp of approval of the District Judge. The order approving the present plan for submission to creditors provided "It further appearing that said plan of reorganization, as amended, complies with the provision of Section 216 of the Bankruptcy Act of 1938 *and that it is fair, equitable and feasible.* (Emphasis supplied.) It is therefore ordered that the report of the Referee "is hereby approved" (R. 119). The Referee found "that the debtor's proposed plan of reorganization * * * is fair, equitable and feasible, and may be approved by your Honor pursuant to the provisions of Section 174 of Chapter X of the Bankruptcy Act" (R. 108).

The notice sent out to all creditors and shareholders opened with the language: "Notice is hereby given that an order was entered by the above entitled court in the above entitled cause on November 12, 1942, *approving a Plan of Reorganization*, as amended, proposed in the above cause by the Debtor as fair, equitable and feasible and in compliance with Section 216 of the Bankruptcy Act of 1938 * * *" (R. 121). With such authoritative language of approval what will an ordinary creditor do but consent to the plan?

It is plain, therefore, that it is not enough for the Court to gather competent valuation data at any time before the plan is confirmed. One of the very purposes of the hearing on plans prior to submission is to enable the court to arrive at an independent judgment before consent of creditors and stockholders is sought, especially when that seeking is accompanied by official language of approval.

One of the most important elements of fact which the court should take into consideration is the determination

of value which necessarily involves the consideration of earning capacity. Especially is an accurate valuation necessary in the case of a real estate corporation, because value determines what, in terms of money, the creditors will receive and when and under what conditions they will be paid.

Petitioner urges that the action of the District Court in contenting itself with examining valuation data after the submission of the plan and after consents have been obtained presents a procedural inaccuracy and error of grave import affecting, as it does, the substantial rights of creditors. This, it is respectfully urged, should not be sanctioned by this Court and given the dignity of even temporary precedent by the denial of certiorari.

On the contrary the prime importance of a complete hearing on a plan of reorganization before submission to security holders should be the subject of definite pronouncement by this Court.

V.

In answer to petitioner's Point V, to the effect that the failure of the District Court to compel the Indenture Trustee to make a complete disclosure of its activities constituted an error which the Court of Appeals failed to correct, the respondents argue (Respondents' Br. 20) that the record discloses no conflicting interests of the Indenture Trustee nor any failure by it to make a complete disclosure of its activities. In petitioner's brief in support of this application for certiorari, the Court's attention was called to its former opinion in *Woods* v. *City National Bank and Trust Company of Chicago*, 312 U. S. 362, and *American United Mutual Life Insurance Company* v. *City of Avon Park*, 311 U. S. 138, in each of which opinions the Court not only questions the propriety of a trustee acting in a dual capacity, but, also, insists that the

minimum requirement for fair dealing in such cases is the elementary obligation of full disclosure of all of such trustee's interests.

The Indenture Trustee in the case at bar is chargeable with a rigid singleness of purpose in protecting its *cestuis*, the bondholders. Obviously, if such a trustee not only possesses an individual interest in ownership of bonds, but also actively co-operates in the proposal, approval and confirmation of the *Debtor's* Plan of Reorganization, it performs a dual and triple function and participates in the representation of conflicting interests. All of this is present in the case at bar.

When it is remembered that consents and approval by creditors and stockholders are necessary prerequisites to final confirmation, the activities of the Indenture Trustee, in its active sponsorship of the Debtor's Plan, become significant. Certainly the interests of the Debtor and the interests of the bondholders are necessarily in opposition. And yet, so far as the record discloses, the bondholders were never advised as to the acts and conduct of their Trustee in connection with the reorganization proceedings in the District Court.

An effort was made by petitioner to show that it is this indenture trustee's policy to promote extensions of mortgage debts previously underwritten by it because such extensions perpetuate trusts to the financial benefit of the trustee. This effort was promptly suppressed by the Referee who said, "It (the present respondent) is indenture trustee on a lot of properties. I know that and every referee and every judge knows that. I don't want you to go into details" (R. 35).

No one at all familiar with this record could fail to perceive how far the Indenture Trustee strayed from the circumscribed field of its lawful place as trustee. It did not

and could not, under the facts, observe that quality of disinterestedness which is a necessary and inherent part of trusteeship.

Two officers and one employee of the Indenture Trustee, without request from any bondholder, formed the original Bondholders' Committee (R. 21). The original communication of this Committee to the bondholders (Bondholders' Exhibit 1, R. 44-46) stated that the Committee had been created by a deposit agreement, and then announced what was termed a "program." In this program, the communication stated, "the owners have tentatively suggested a further renewal, say for another six years, with interest at the rate of 4½% per annum (which is the average rate of interest paid during the last six years); and with a continuance of the provision for sinking fund deposits, to be used for the purchase and retirement of the notes. The Committee feels that this proposal has much in its favor, for not only does it offer an attractive rate of interest to those noteholders who look chiefly to the income from their investments, but it will also provide frequent opportunity to those seeking to liquidate their holdings, whereby they may do so without undue sacrifice of principal."

The letter to the bondholders then went on to say that the Committee would be very happy to work with them. A deposit of the bonds was sought, and a deposit agreement (giving the Committee authority to adopt *any* plan, R. 47), making the deposit irrevocable, without the written consent of the Committee, proceeded to grant complete power to the Committee over the interests of the depositing bondholders (R. 46-48).

This Committee was dissolved on the complaint of the Securities and Exchange Commission because it issued but failed to register certificates of deposits as required by the Securities Act of 1933. The deposit of the bonds was again solicited by the same three men who constituted the Bondholdes' Committee, who, under the new scheme,

sought the deposits by requesting appointment as "attorneys in fact" (R. 52). As had been said, these individuals were Francis J. Burke, Vice-President of the Indenture Trustee; Arthur G. Rathje, President of the Indenture Trustee; and Wilbur R. Haynie, an employee of the Indenture Trustee, in charge of the servicing of bond issues and liquidation trusts (R. 20-21).

When it came to procuring experts to evaluate the Debtor's property, Mr. Haynie was called, ostensibly by the Debtor, and he testified as to the value on the hearing prior to the submission of the Plan to creditors (R. 21). After the court approved the plan and consents had been obtained, and after petitioner had produced Mr. McKey, who said the property was worth $139,500, Mr. Ivar W. Turnquist was called as a witness, for valuation, by the Debtor, and it developed that he was the Vice-President and sales manager of Swan-Lorish Company, which concern, as real estate brokers, managed and sold properties for the Indenture Trustee (R. 41). Mr. Chester W. Kulp, the attorney for the Indenture Trustee, is a member of the Board of Directors of both the Indenture Trustee and Swan-Lorish Company (R. 41).

It is interesting to observe that Mr. Kulp represented not only the Indenture Trustee, but also the Bondholders' Committee and the "attorneys in fact" and he said "that he had something to do with the drafting of the Plan of Reorganization submitted by the Debtor" (R. 39). During the progress of the proceedings, Mr. Kulp conducted the direct examination of Mr. Haynie (R. 20); the cross-examination of Mr. Lundgren, when called as a witness on behalf of the bondholders (R. 26); and he cross-examined Frank M. McKey, the expert called as a witness by the Objecting Bondholder (R. 31). It was he, also, who objected to certain questions asked under cross-examination of Turniqust and Haynie by counsel for this petitioner (R. 42).

The significance of the fact that the Plan, as finally confirmed by the District Court, providing for a six-year extension and the $4\frac{1}{2}\%$ "average" interest rate, was exactly the proposal made by the three officers of the Indenture Trustee, when, acting as a self-appointed Committee, they sent their original communication to the bondholders, soliciting the deposit of bonds and complete authority over the depositors' interests, will not escape the Court (R. 44-50).

The story of the events touching the original solicitation of bondholders and the activities of the Indenture Trustee, acting through its own representatives, in procuring consents of the bondholders to the Debtor's Plan, appears, among other places, in the testimony of Mr. Haynie, who said that while they did not solicit acceptances or consents to the Plan by letters, many of the bondholders were talked to as they came into the Bank and "in most cases we recommended the Plan." He said, also, that "most of the bondholders signed up" (R. 37).

The Indenture Trustee owns, in its own right, some \$11,100 of the bonds and holds in other capacities over \$6,000 in bonds (R. 85-6). It is settled that a trustee may not profit by the trust. The trustee here is limited in its right to vote to the amount paid for the bonds it owns; its participation in the benefits of the reorganization is similarly restricted. If it has trafficed in the bonds it must account and pay over any profit it has made. As this Court has said, *City of Avon* case, 311 U. S. 138, the Bankruptcy Court "has power to adjust the remedy to meet the need". The Indenture Trustee here has made no disclosure. Until disclosure as to such matters is made appropriate action cannot be taken.

The Indenture Trustee expects to continue to receive trustee's fees; it expects to continue to receive bank deposits. Its lawyer, in all probability, will petition for fees

for aiding in the formulation and adoption of the plan. By its position, it can, and it is believed it will, exercise a practical power over the debtor's affairs. It is in a position to pick up the bonds at reduced prices.

The only Brief filed in opposition to this Application for Certiorari is filed by "Walter E. Wiles, Counsel for Respondent, Chicago City Bank and Trust Company, Indenture Trustee" (Respondents' Br. 27). Thus, in this final stage of the proceedings, the Indenture Trustee is found conducting the battle in opposition to its own beneficiaries in resisting Petitioner's Application, a task which would seem normally to be the business of the Debtor, the alleged proponent of the Plan.

It is believed that the activities of the Indenture Trustee, demonstrated by the present record, are not in accord with the expressed ideas of this Court as to the proper function and scope of activity of such fiduciaries, and petitioner respectfully suggests that a plan so conceived, so sponsored, and so achieved should be the subject of full inquiry by this Court on a review of the record.

VI.

A proposal was made by the petitioner for the sale of the property at an upset price as authorized by Chapter X, Section 216 (10) of the Bankruptcy Act. The proposal was rejected by the referee on the ground that "Chapter X contemplates reorganization rather than liquidation" (R. 104).

This rejection was based on a misconception of the decision in *Fidelity Assurance Association* v. *Sims*, 318 U. S. 608. As observed in our original petition, the *Sims* case does not prohibit a plan providing for a sale of the debtor's property at an upset price. The *Sims* case in-

volved the question whether the original petition was filed in good faith, because *at the outset of the proceedings,* it appeared unreasonable under the facts and circumstances of that case to expect anything other than liquidation.

A decision by this Court on the question whether or not (after the question of good faith has been decided) a plan may provide for the sale of the debtor's property at an upset price, is of vital importance in reorganization law. Real estate enterprises constitute a large percentage of reorganization proceedings in the Federal Courts. It is frequently desirable to sell the debtor's real estate under a plan. In view of the present favorable real estate market, it was and is, we submit, for the best interests of the bondholders to consider a plan providing for a sale.

CONCLUSION.

For the reasons assigned in the Petition for Writ of Certiorari and in the brief filed in support thereof, and for the additional reasons expressed in the preceding pages, it is again urged that the Writ of Certiorari be granted by this Court, ordering the Circuit Court of Appeals, for the Seventh Circuit, to certify the record to this Court for complete review.

Respectfully submitted,

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